



Impact of change in benchmark on large cap funds

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Abstract

Mutual fund has become one of the most preferred choice of investment among the people. It is essential to evaluate the funds in order to determine its efficiency. Comparison of funds' performance with its respective benchmark is the first base for evaluation. However from January 2018, SEBI has directed all the funds' to evaluate the funds on basis of Total Return Index instead of Price Return Index. The paper evaluates the impact of change in benchmark on Large Cap funds.

Keywords: benchmark, large cap funds, SEBI

Introduction

Index is cluster of similar stocks which represent the market price of underlying stocks. Sum of prices of underlying securities determines the value of that index. Any changes in price of underlying stocks would result in changes in value of that index. It is a reference point against which a mutual fund can be evaluated. It is essential as investor can decide on efficiency of their fund manager. Hence it can be said that it serves as a benchmark for evaluating mutual funds. Till January 2018, Price Return Index was used to compare and evaluate performance of funds. However, SEBI directed the mutual fund houses to consider Total Return Index from February 1, 2018 as benchmark for comparison and evaluation of the funds. Out of various categories of equity mutual funds, large cap funds are considered to be the most consistent and stable. They invest majority of the corpus in market leaders that have proved their mettle and have rock solid track record. However the only limitation of these funds is that they do not have the potential to yield very high returns. As of 20th December 2019, the large cap category delivered an annual average return of 10.54%, according to Value Research data. It becomes essential to determine whether the change in index has any impact on evaluation of large cap funds.

Literature Review

Brinson, Hood, Beebower (1995) ^[1] demonstrated that the over and underperformance strongly depend on the benchmark index applied. Malik N.S and Suresh Kumar Mittal (2007) ^[2] analysed the performance of 74 equity funds from 1986 to 2006 indicated that the actively managed funds outperformed the market benchmark.

In private sector category (26), 21.92 percent funds had outperformed and in public sector funds (48), only 15.38 percent funds had outperformed the benchmark.

Dr. Karrupasamy, R., Mrs. Vanaja, V. (2014) ^[3] revealed that majority of the public sector schemes selected for the study outperformed the category average and also benchmark indices and majority of the diversified schemes performed well on the basis of performance index. Philips, C. B., Kinniry, F. M. Jr., & Walker, D. (2014) ^[4], analysed that mutual fund performance outperforms the benchmark yearly on average by 1.3%. Suchitashukla (2015) ^[5] analyzed the financial performance in terms of risk –return relationship of selected mutual fund schemes.

The study revealed that overall the mutual funds gave better returns than the benchmark in the above period subject to infrastructure fund in year 2013. M.M.Goyal (2015) ^[6], evaluated the performance of top 10 mutual funds schemes. He found that overall all the schemes provided higher and better average return than the market.

Objective

The objective of the study is to determine the impact of change in benchmark index from Price Return Index to Total Return Index in evaluating large cap funds in ten years, five years, three years and one year period of investment.

Sample Selection

All the large cap funds whose returns for the period of one, three, five and ten years are available at moneycontrol.com have been considered and they are taken as samples.

Returns of the funds are compared with returns of Price Return Index and Total Return Index of National Stock Exchange's Benchmark Nifty 50 as it is the appropriate representation of large cap funds.

Funds selected for the study are as under.

Table 1: Funds Selected for the Study

No.	Name of the funds
1	BNP Paribas Large Cap Fund – Growth Large Cap Fund
2	LIC MF Large Cap Fund – Growth Large Cap Fund
3	HSBC Large Cap Equity Fund – Growth Large Cap Fund

4	L&T India Large Cap Fund – Growth Large Cap Fund
5	Edelweiss Large Cap Fund – Growth Large Cap Fund
6	Mirae Asset Large Cap Fund - Regular – Growth Large Cap Fund
7	Kotak Bluechip Fund – Growth Large Cap Fund
8	Kotak Bluechip Fund – Growth Large Cap Fund
9	SBI Blue Chip Fund – Growth Large Cap Fund
10	UTI Mastershare Unit Scheme – Growth Large Cap Fund
11	PGIM India Large Cap Fund – Growth Large Cap Fund
12	Tata Large Cap Fund - Regular Plan – Growth Large Cap Fund
13	Invesco India Largecap Fund – Growth Large Cap Fund
14	ICICI Prudential Bluechip Fund – Growth Large Cap Fund
15	IDFC Large Cap - Regular Plan – Growth Large Cap Fund
16	JM Large Cap Fund – Growth Large Cap Fund
17	DSP Top 100 Equity Fund - Regular Plan – Growth Large Cap Fund
18	Nippon India Large Cap Fund – Growth Large Cap Fund
19	HDFC Top 100 Fund – Growth Large Cap Fund
20	HDFC Top 100 Fund – Growth Large Cap Fund
21	Aditya Birla Sun Life Frontline Equity Fund - Regular Plan – Growth Large Cap Fund
22	Taurus Largecap Equity Fund - Growth Large Cap Fund
23	Franklin India Bluechip Fund - Growth Large Cap Fund
24	Franklin India Bluechip Fund - Growth Large Cap Fund
25	ICICI Prudential Bluechip Fund - Institutional Option I – Growth Large Cap Fund
26	Sahara Super 20 Fund – Growth Large Cap Fund

Data Collection

Opening and closing values of Price Return Index and Total Return Index for one, three, five and ten years of the index Nifty 50 have been collected from NSE.

Website <https://www1.nseindia.com/>. Returns of large cap funds are calculated from Net Asset Values of the funds collected from moneycontrol.com.

Tools and Techniques

One year absolute and three, five and ten years compounded annualised.

returns of the Total Return Index and Price Return Index of Nifty 50 as per their closing values and that of the funds are used to determine whether there is difference in their performance between both the index and the large cap funds.

Period of the Study

The study consists of ten years period from January 01, 2010 to December 31, 2019.

Significance of the Study

SEBI has made it mandatory for the funds to compare their performance against Total Return Index from February 2018. Earlier funds were compared against Price Returns Index which does not consider the dividends distributed by the component stocks. Large cap funds are well known for their stability and consistency but their outperformance over index is lower as compared to other category of equity funds. Thus it becomes significant for investors of large cap funds to determine whether the fund managers are skilful enough to beat the new index or they need to rethink on their investment.

Limitations of Study

The study evaluates impact of change in benchmark only on large cap funds using National Stock Exchange Index NIFTY 50. Only one, three, five and ten years' returns ending on December 31, 2019 have been considered for comparison. Returns of three years, five years and ten years period is annualised.

Discussion

Table 2: 10 years', 5 years', 3 years' annualised and one year's return as on December 31, 2019 of the funds and the Index

Name of funds/Index	10 Years' Annualised Return	5 Years' Annualised Return	3 Years' Annualised Return	1 Year's Return
BNP Paribas Large Cap Fund – Growth Large Cap Fund	12.05%	8.81%	15.52%	16.82%
LIC MF Large Cap Fund – Growth Large Cap Fund	9.24%	7.89%	13.64%	14.98%
HSBC Large Cap Equity Fund – Growth Large Cap Fund	9.08%	8.76%	13.30%	14.82%
L&T India Large Cap Fund – Growth Large Cap Fund	10.78%	7.65%	12.86%	12.93%
Edelweiss Large Cap Fund – Growth Large Cap Fund	11.14%	8.93%	14.90%	11.29%
Mirae Asset Large Cap Fund - Regular – Growth Large Cap Fund	14.40%	11.75%	15.77%	12.52%
Kotak Bluechip Fund – Growth Large Cap Fund	10.36%	9.05%	13.02%	14.02%
Kotak Bluechip Fund – Growth Large Cap Fund	10.36%	9.05%	13.02%	14.02%
SBI Blue Chip Fund – Growth Large Cap Fund	11.39%	9.53%	11.70%	11.44%
UTI Mastershare Unit Scheme – Growth Large Cap Fund	10.27%	8.05%	12.62%	10.38%
PGIM India Large Cap Fund – Growth Large Cap Fund	9.36%	8.19%	12.25%	14.23%
Tata Large Cap Fund - Regular Plan – Growth Large Cap Fund	9.94%	7.83%	11.84%	11.65%
Invesco India Largecap Fund – Growth Large Cap Fund	10.19%	8.72%	12.17%	10.08%
ICICI Prudential Bluechip Fund – Growth Large Cap Fund	12.52%	9.20%	13.05%	9.42%

IDFC Large Cap - Regular Plan – Growth Large Cap Fund	8.69%	7.13%	12.41%	10.40%
JM Large Cap Fund – Growth Large Cap Fund	6.73%	5.11%	8.51%	4.74%
DSP Top 100 Equity Fund - Regular Plan – Growth Large Cap Fund	9.51%	7.61%	12.22%	14.42%
Nippon India Large Cap Fund – Growth Large Cap Fund	11.80%	8.86%	13.99%	6.65%
HDFC Top 100 Fund – Growth Large Cap Fund	10.73%	7.69%	12.47%	7.08%
HDFC Top 100 Fund – Growth Large Cap Fund	10.73%	7.69%	12.47%	7.08%
Aditya Birla Sun Life Frontline Equity Fund - Regular Plan – Growth Large Cap Fund	11.30%	8.15%	10.91%	7.40%
Taurus Largecap Equity Fund – Growth Large Cap Fund	6.79%	5.29%	8.52%	8.21%
Franklin India Bluechip Fund – Growth Large Cap Fund	9.74%	6.79%	8.62%	5.10%
Franklin India Bluechip Fund – Growth Large Cap Fund	9.74%	6.79%	8.62%	5.10%
ICICI Prudential Bluechip Fund - Institutional Option I – Growth Large Cap Fund	13.48%	10.20%	14.03%	10.13%
Sahara Super 20 Fund – Growth Large Cap Fund	7.09%	6.16%	10.37%	11.54%
Nifty 50 Price Return Index	11.53%	14.15%	7.99%	8.81%
Nifty 50 Total Return Index	12.99%	15.68%	9.38%	10.15%

<https://www.moneycontrol.com/mutual-funds/performance-tracker/p2p-returns/large-cap-fund.html?fromDate=2019-01-01&sellDate=2019-12-31>

The above table indicated that the Total Return Index yielded 12.99%, 15.68%, 9.38% and 10.15% returns for the period of ten, five, three and one year ending on 31st December, 2019 while Price Return Index yielded 11.53%, 14.15%, 7.99% and 8.81% for the period of ten, five, three and one year ending on 31st December, 2019. There is a difference of annualised return of 1.46%, 1.53%, 1.59% and 1.34% between that of Price Return Index and Total Return Index of Nifty 50. It means over performance of the funds would reduce and the underperformance would increase when funds are compared with Total Return Index by annualised rate of 1.46%, 1.53%, 1.59% and 1.34% as compared to Price Return Index. Out of total 26 funds under study, 22 funds over performed Price Returns Index of Nifty 50 for the period of 10 years while only 15 funds were able to beat the Total Return Index of Nifty 50 for that period. Similarly, in period of five years, 14 over performed Price Return Index but only 3 beat the benchmark of Total Return Index. In the period of three years, 3 funds beat Price Return Index but only 1 beat Total Return Index. In period of one year, 11 funds outperformed Price Return Index but only 7 funds were able to beat Total Return Index.

Conclusion

Returns as per Total Return Index of Nifty 50 is more than Price Return Index of the same benchmark as it tracks both capital gains and distribution of dividends as compared to only capital appreciation in Price Return Index. Hence it is more appropriate index to compare the returns of the funds and it will provide more transparent results. During the period of ten years ending on December 31, 2019, 85.6% funds over performed Price Return Index but only 38.4% funds over performed Total Return Index of Nifty 50. In period of five years, 53.8% funds beat Price Return Index but only 11.5% funds were able to beat Total Return Index. In the period of three years, 11.5% beat Price Return Index but only 3.8% beat Total Return Index. In the period of one year, 42.3% funds were able to beat Price Return Index while only 26.9% funds beat Total Return Index. Hence Total Return Index is the tougher index to beat as compared to Price Return Index. This will make fund manager's task harder and they will be more conscious and more performance oriented. It will help investors to decide more diligently about their investment decisions. In the opinions of experts, Kalpen Parekh, President, DSP BlackRock Investment Managers said, "Our move to disclose returns against

TRI will help in giving the right picture of the real alpha generated by active fund management. The alpha that is shown currently may look overstated as dividends are not added in benchmark returns. By comparing a fund's performance against a Total Returns Index, funds would be adopting a higher standard of reporting which in turn increases the level of transparency to investors. We feel benchmarking to TRI is a step towards responsible and transparent communication with our advisors and investors and also sets high standards in investment management," he added.

Kaustubh Belapurkar, Director Manager Research, Morningstar Investment Adviser India, believes, "This is a move in the right direction.

Mutual funds investing in stocks, benefit from both the price movement as well as dividends being paid out by the stocks. Comparing the fund performance to the Total Returns index is a fair and transparent mechanism for capturing the true alpha that is being generated through active management. While this will reduce the perceived alpha being generated, it will give investors a better comparison and truer picture of how their investments are performing."

The total return index follow a similar pattern in which many mutual funds operate, where all resulting cash payouts are automatically reinvested back into the fund and hence it is better benchmark to gauge the performance of the funds.

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